Laboratory of Policies for Fiscal Equity (LAPEF)

# Helping Governments to **Make Fiscal Policy More Equitable** with LAPEF

AUTHORS:
Karen Astudillo and Carola Pessino,
Fiscal Management Division (IFD/FMM)

IDB

**JEL Codes:** D31, E26, H22, H26, H31, N36

**Keywords:** fiscal policy; public spending; taxes; inequality, poverty, Latin America



Inter-American Development Bank
1300 New York Avenue, N.W.
Washington, D.C. 20577
www.iadb.org

# An Opportunity to Build a More Equitable Future


Traditionally, by using **government spending and taxation,** fiscal policy has focused on **stabilizing the economy, reducing unemployment, promoting efficiency and growth,** and maintaining **sustainable public finances.** Over time, the emphasis on these objectives has varied based on economic conditions and political priorities. Several fiscal institutions and tools were created or strengthened devoted to control and solve those problems: the **budget cycle, tax policy and tax administration, and medium-term fiscal frameworks including debt sustainability tools.**

Fiscal policy has lately begun to address not only **tax and spending sufficiency** and **efficiency** but also **equity.** In fact, the **Latin American and Caribbean region** is one of the most **unequal regions** in the world. **Structural inequality** is exacerbated by a limited **fiscal capacity** and low **progressivity of public spending and taxation.** Strengthening the design of fiscal policy to ensure its **redistributive efficiency** offers an opportunity for governments to promote **equitable economic growth** and reduce **inequality. Fiscal equity institutions and tools** facilitate **fiscal consolidation** that safeguards the poor and vulnerable, enabling the implementation of needed but socially and politically sensitive reforms without sparking social unrest.

Unlike other fiscal policy objectives, which benefit from **dedicated government departments, established tools,** and **trained personnel, fiscal equity** in most countries remains largely dependent on the **intuition and judgment of economic or finance ministers.** This is because they often lack the necessary **knowledge, theoretical framework, empirical evidence,** and **proven implementation tools** to effectively put it into practice.

To bridge this gap, the Fiscal Management Division of the Inter-American Bank created the **Fiscal Equity Policy Lab (LAPEF)**. This innovative solution analyzes the fairness of various fiscal interventions and provides technical and practical advice to governments in the region helping them design and implement efficient tax and spending policies that minimize the burden on the poor as effectively as possible, ultimately contributing to a more **equitable society.**

**LAPEF** includes fiscal microsimulation models that evaluate, before it happens, what would occur in the economic and social conditions of households if the State modifies a tax, a public transfer or any other more complex fiscal policy. These models have as its unit of analysis the household. This allows us to understand the impact on variables that interest the policymaker before adopting a given policy: **revenue levels, income, consumption, employment level and type, inequality,** and **poverty,** among other economic variables.

**LAPEF** contributes cutting-edge methodologies to develop **evidence-based fiscal policies,** drawing from experiences from the **Latin American and Caribbean region**. It aims to improve **fiscal sustainability** while minimizing the impact on the poor, preserving their well-being. Furthermore, LAPEF simulates diverse fiscal reform scenarios, predicting their effects on critical economic and social variables, with a focus on **equity** and **economic efficiency.** These microsimulations require three essential inputs: **1) comprehensive knowledge of fiscal legislation,** detailing public policy operations in each country; **2) household income and expenditure surveys** from statistical institutes; and **3)** crucially, **administrative tax and spending data** to align survey data with the real fiscal experiences of households.

To design fiscal policies that **minimize negative impacts on household well-being,** policymakers must address key questions:

- To what extent do existing taxes and public spending **address and mitigate** poverty and inequality?
- How **progressive, regressive, or redistributive** are these policies?
- How effectively do they **target** the most vulnerable populations?
- Who are the **winners and losers** of current fiscal structures or proposed reforms?

Answering these questions is **crucial** for designing fiscal policies that lead to **better redistributive outcomes.** Ultimately, the challenge is to make **fiscal policy more equitable.** This underscores the need for a **paradigm shift—**moving beyond a singular focus on efficiency and economic growth to **a holistic approach that integrates equity into all aspects of fiscal policymaking.**

**Two distinctive features of LAPEF stand out: its ability to combine cutting-edge fiscal modeling with a deep understanding of real-world policy constraints, and its practical approach to guiding policymakers through complex trade-offs in taxation and public spending.** Unlike traditional poverty reduction frameworks, which focus solely on redistribution, LAPEF takes a **holistic approach,** integrating **equity, efficiency, fiscal sustainability, and economic growth** into fiscal policymaking. By identifying policies that minimize unintended consequences—such as work disincentives, informality subsidies, and spending inefficiencies—LAPEF helps governments design **smarter, more effective interventions.**

Leveraging a **rigorous methodological framework** and a **combination of survey and administrative data,** LAPEF reconstructs the structure of tax systems and public spending, allowing policymakers to **quantify the real impact of fiscal reforms.** Its standardized approach enables **cross-country comparisons** and tracks **inequality and redistributive effectiveness over time,** providing governments with a **reliable, data-driven foundation** for making fiscal policy fairer and more sustainable.

However, **moving from theory and microsimulations to real-world implementation is a significant challenge.** For example, transitioning from **universal subsidies to targeted social tariffs** requires not only sound policy design but also a **robust administrative data system** to ensure effective targeting. Recognizing these complexities, **LAPEF incorporates theory, empirical microsimulations, and implementation science into its tools,** bridging the gap between analysis and execution. Backed by a team of experts—including **creators and developers of these methodologies in the region**—LAPEF provides governments with **the technical capacity and practical knowledge** needed to turn policy insights into tangible, equitable reforms.

**LAPEF** equips governments with essential tools **to manage fiscal equity effectively,** simulating the impact of tax and spending policies on poverty, inequality, and fiscal sustainability. It helps policymakers identify winners and losers, design compensation for vulnerable groups, and reduce work disincentives by encouraging formal employment. **LAPEF emphasizes long-term sustainability** prioritizing investments in **human capital,** particularly for the most vulnerable, while also addressing inequities in **resource allocation.** It fosters inclusivity by considering marginalized groups and integrating **equitable climate change** considerations into policy design.

## Key LAPEF tools include:

- **Country-specific incidence analysis:** This methodology evaluates the distributional impacts of tax and spending policies on income and poverty, using household data and fiscal information. It has been applied in countries such as Argentina, Bolivia, Brazil, Colombia, and Uruguay.

- **Fiscal policy reform microsimulations: LAPEF's** microsimulation models analyze household-level impacts of policy changes, considering behavioral and indirect effects such as changes in labor supply and informal sector participation. It also accounts for **tax exemptions, informality,** and spending policies like **energy subsidies** and the **personalized value added tax (VAT).** The personalized VAT, for instance, allows for a reduction in regressive exemptions on certain products through progressive rebates for low-income households, which maximizes tax revenues and ensures a more efficient redistribution of resources. Several microsimulations of subsidies and the personalized VAT have been run for Argentina, Bolivia, Colombia, and other countries.

- **Fiscal intelligence ecosystem:** A key implementation system that enables more precise targeting of tax and spending policies. By utilizing a combination of **administrative data systems** and **microsimulation models,** it allows governments to better identify and reach the most vulnerable populations while ensuring that policies are tailored to local conditions and realities.

**LAPEF's** data-driven approach moves beyond theory, enabling policymakers to design fair and efficient systems that reduce possible inequitable and unwanted effects of fiscal policy, increase compliance, and ensure fiscal sustainability. By grounding policies in real-world data, **LAPEF** helps build trust, reduce waste, and create equitable, stable economic futures.

# Creating Institutions for Advancing Fiscal Equity

**LAPEF** enables **transversal fiscal equity management** across the entire public sector, consolidating and coordinating budgets and fiscal equity instruments. Its tools empower **ministries of finance** to manage the equity impact of government programs through a comprehensive and coordinated approach.

**LAPEF** promotes the creation of **fiscal equity institutions** to reduce poverty and inequality in a consistent and rigorous way. While sophisticated analytical tools are essential, their impact is limited without robust institutional frameworks within ministries of finance, specifically designed to prioritize **equity considerations** at every stage of policy design and implementation.

This requires a shift from a narrow focus on **efficiency** and **growth** toward a more holistic approach that integrates equity into all aspects of fiscal policymaking. By strengthening these institutions and equipping them with the necessary data, tools, and expertise, governments can effectively translate the insights generated by the **LAPEF** into concrete policy actions that make fiscal policies more equitable while ensuring efficiency and sustainability.

Smart fiscal policy begins with with diagnostics using **real data and strong institutions.** When taxation and spending align with actual impacts, governments can design fairer, more efficient systems that drive growth, reduce inequality, and build **public trust.** Robust fiscal institutions ensure policies are **sustainable, transparent,** and **adaptable,** leading to stronger economies and a more **equitable future.**

# Is this the solution for your country?

The Fiscal Management Division of the Inter-American Development Bank is seeking fiscal leaders to collaborate closely with LAPEF's technical team to advance fiscal equity. Initial requirements include the following:

1. **Access to recent, representative household and expenditure surveys**
2. **A detailed breakdown of tax types and expenditure components**
3. **Input–output matrices**
4. **Administrative tax and spending data**

If you are committed to fostering equitable fiscal policies, we welcome the opportunity to collaborate with you.

## Join us in advancing fairer fiscal policies!

**Contact us:** fiscalequitypolicylab@iadb.org

IDB